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**STATE OF WISCONSIN
DEPARTMENT OF EMPLOYEE TRUST FUNDS
801 West Badger Road
Madison, WI 53713**

CORRESPONDENCE MEMORANDUM

DATE: February 25, 2003

TO: Employee Trust Funds Board

FROM: Julie Reneau, Administrator
Retirement Services Division

SUBJECT: Pursuing Statutory Change to Fixed Dividend Payment Threshold

Background

In December 2002, the Board exercised its discretionary authority under Wis. Stat. § 40.27 (2) (c), to establish a policy that a negative fixed annuity dividend would be applied to dividends effective on March 1, 2003 only if there was a calculated loss in the dividend greater than .5% (i.e. -.5%). The actuary determined that the calculated loss was .3% (-.3%); therefore, this loss will be carried over to next year's dividend calculation. (Note: the Board recently approved and Secretary Stanchfield promulgated an emergency rule changing the annuitant dividend effective date from March 1 to April 1 2003.)

Payment of a fixed dividend is set by statute. Wisconsin Stat. § 40.27 (2) (intro.) provides a threshold for distributing surpluses in the fixed annuity reserve. This statute provides that surpluses in the fixed annuity reserve,

“ . . .shall be distributed by the board if the distribution will result in at least a 2% increase in the amount of annuities in force, on recommendation of the actuary. . . ”

At the December Board meeting, the Board did not take any action regarding potential statutory changes to the payment of fixed dividends. Rather, the Board asked staff to further analyze the issue and bring back recommendations at a future Board meeting.

Issue

Should the Board request that Department staff pursue a statutory change to lower the current 2% threshold for paying fixed dividends to annuitants?

Recommendation

Department staff be requested to pursue changing the dividend payment threshold to be symmetrical with the current loss threshold policy of greater than .5% (-.5%). This would mean that dividends would be distributed when the dividend calculation results in an increase of greater than .5% in the amount of annuities in force.

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Any percentage less than .5% would carry over to the following year's dividend calculation.

Discussion

With current economic assumptions, the system is designed to produce approximately an average 2.9% annual fixed dividend. This means that since past accruals of unrecognized market gains are gone, there will be many years when the amount available for dividends could fall below the 2% statutory threshold.

In addition, the Trust Fund has recently experienced the effects of a prolonged market downturn. In the past three years, the State of Wisconsin Investment Board has reported negative returns in the Fixed Trust Fund of -.8%, -2.3% and - 8.8% for 2000, 2001 and 2002, respectively. These losses have been smoothed through the Market Recognition Account, thus distributing each year's loss over a five-year period. The majority of these losses have therefore not yet been recognized under the MRA. Taking both of these factors into consideration, it means that for the foreseeable future, dividends could be low, non-existent or negative.

We know that it would take a gain of over 24% to generate a 2% dividend. Similarly, it would take a 16% investment return to generate a dividend greater than .5%. However, despite the unlikelihood that investment returns will allow any dividend in 2003, staff feels there is merit in the Board deciding on any changes now so that the process of obtaining a statutory change may begin. Proposed statutory changes often take 1 to 2 years to be passed into law.

As noted in past meetings, the actuary prefers and recommends symmetry in the application of dividend distributions and dividend recovery.

Summary

Seeking statutory change takes time. If the Board wishes to have the current statute changed, we recommend that the Board take action at this time. While this change from a 2% dividend threshold to a new threshold of greater than .5% seems small, it is not insignificant to members on limited budgets who depend on their annuities as the main source of income.

Attached are documents that will assist in the review of the threshold issue. We look forward to discussion on this topic in March.